9 June 2020

Carborundum Universal

Rating: **Buy**
Target Price: ₹303
Share Price: ₹243

Early beneficiary of normalcy in industrial activity; Buy

The steep drops (of 24% y/y) in revenue from abrasives and (of 16% y/y) from ceramics reflects weak industrial activity, aggravated by the Covid-19 lockdown. Consolidated sales fell 15% y/y due to the much more-than-expected weak home market. The margin, however, at 17.3% was a surprise, the higher gross margin driven by a better product-mix and lower commodity prices. Management is confident of a steady margin ahead, focusing on operating efficiency, cost control, launches of products in ceramics moving out of the loss-suffering Foskor Zirconia this year. We have raised earnings estimates with moderate increase in revenues and higher EBITDA margin for FY21/22e. We upgrade the stock to a Buy with a revised TP of ₹303 (22x FY22e) up from ₹244.

Demand to pick up in-line with industrial activity: Management expects demand to pick up in-line with improving utilization level of key industries such as autos and construction. On the commissioning of the new coated-maker in Q4 FY20 and rising demand, we expect coated-abrasives sales to grow in FY21. Also, the new Metz cylinder capacity will be expanded in H2 FY21 from 1.7m pieces to 2.2m.

Margins to expand: Stiff competition in abrasives and a fall in sales of margin-accretive diesel-particulate filters (electro-mineral) led to pressure on margins. With its focus on operating efficiency, cost-control, launches of products in ceramics and exiting the loss-making Foskor Zirconia this year, management is confident of steady margins ahead,. We expect the consolidated EBITDA margin to step up from 15.3% in FY20 to ~16% in FY22.

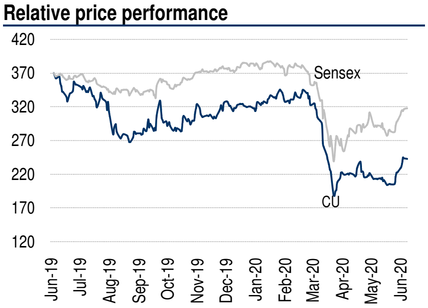
Valuation. Despite the near-term dimmer abrasives and electro-minerals outlook, the growth momentum in engineered ceramics and metallised cylinders is good. We expect margins to improve over FY20-22, and drive earnings growth. Hence, we upgrade our rating on the stock to a Buy. **Risks:** Drag in industrial production for long, delay in the sale of Fosker Zirconia.

Key data	CU IN / CRBR.BO
52-week high / low	₹379 / 175
Sensex / Nifty	34371 / 10167
3-m average volume	$0.3m
Market cap	₹46bn / $608.5m
Shares outstanding	189m

Shareholding pattern (%)	Mar' 20	Dec'19	Sep'19
Promoters	42.1	42.1	42.1
- of which, Pledged	0.2	0.2	0.2
Free float	58.0	57.9	58.0
- Foreign institutions	6.5	6.0	5.6
- Domestic institutions	28.2	27.6	26.7
- Public	23.2	24.3	25.7

Estimates revision (%)	FY21e	FY22e
Sales	1.0	6.4
EBITDA	21.6	21.8
EPS	24.1	25.1

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY18	FY19	FY20	FY21e	FY22e
Sales (₹ m)	23,678	26,889	25,990	23,801	27,032
Net profit (₹ m)	2,196	2,476	2,750	2,093	2,612
EPS (₹)	11.6	13.1	14.5	11.1	13.8
PE (x)	29.9	18.8	16.9	22.2	17.8
EV / EBITDA (x)	16.3	10.4	10.9	11.8	9.6
PBV (x)	4.2	2.7	2.5	2.3	2.1
RoE (%)	14.9	15.1	15.4	10.8	12.2
RoCE (%)	18.3	19.3	17.4	12.8	14.6
Dividend yield (%)	0.6	1.1	1.2	0.9	1.2
Net debt / equity (x)	-0.0	-0.1	-0.2	-0.2	-0.2

Source: Company, Anand Rathi Research

Ashwani Sharma
Research Analyst

Quick Glance – Consolidated Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Abrasives (% of sales)	44.0	42.3	38.7	**38.9**	**40.0**
Net revenues	23,678	26,889	25,990	23,801	27,032
Growth (%)	12.0	14.0	-3.2	-8.6	13.7
Material cost	8,049	9,550	8,869	8,123	9,225
Employee & other exps.	11,642	12,957	13,134	12,132	13,499
EBITDA	**3,986**	**4,383**	**3,986**	**3,546**	**4,308**
EBITDA margins (%)	16.8	16.3	15.3	14.9	15.9
- Depreciation	1,060	1,083	1,045	1,180	1,310
Other income	229	273	450	306	352
Interest expenses	86	85	63	65	67
PBT	3,070	3,488	3,328	2,607	3,283
Effective tax rate (%)	33.2	34.7	22.7	25.5	25.5
+ Associates / (Minorities)	147	199	178	151	166
Net income	2,196	2,476	2,750	2,093	2,612
Adjusted income	2,196	2,476	2,750	2,093	2,612
WANS	189	189	189	189	189
FDEPS (₹ / sh)	11.6	13.1	14.5	11.1	13.8
EPS growth (%)	18.8	12.6	11.1	-23.9	24.6

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Share capital	189	189	189	189	189
Net worth	15,644	17,241	18,584	20,300	22,442
Debt	1,248	919	595	696	796
Minority interest	615	523	455	455	455
DTL / (Assets)	274	254	41	41	41
Capital employed	**17,780**	**18,937**	**19,675**	**21,493**	**23,734**
Net tangible assets	6,144	5,687	5,907	5,914	5,890
Net intangible assets	61	40	31	31	31
Goodwill	1,151	1,223	1,330	1,330	1,330
CWIP (tang. & intang.)	303	464	387	387	387
Investments (strategic)	1,232	1,304	1,212	1,212	1,212
Investments (financial)	570	961	675	675	675
Current assets (ex cash)	10,124	11,565	10,343	10,095	11,780
Cash	1,289	975	2,940	4,622	5,301
Current liabilities	3,096	3,282	3,150	2,773	2,872
Working capital	7,028	8,283	7,193	7,322	8,908
Capital deployed	**17,778**	**18,937**	**19,675**	**21,493**	**23,734**
Contingent liabilities	690	886	-	-	-

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
PBT	3,070	3,488	3,328	2,607	3,283
+ Non-cash items	1,075	895	658	939	1,025
Oper. prof. before WC	4,145	4,383	3,986	3,546	4,308
- Incr. / (decr.) in WC	980	1,183	-1,085	29	1,486
Others incl. taxes	1,035	1,353	798	665	837
Operating cash-flow	2,130	1,847	4,273	2,853	1,985
- Capex (tang. + intang.)	-1,013	-766	-1,179	-1,186	-1,286
Free cash-flow	1,117	1,081	3,094	1,666	699
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	425	520	578	440	549
+ Equity raised	0	0	0	-	-
+ Debt raised	-243	-329	-323	101	100
- Fin investments	557	462	-378	-	-
- Misc. (CFI + CFF)	-137	83	435	-355	-429
Net cash-flow	29	-314	2,136	1,682	679

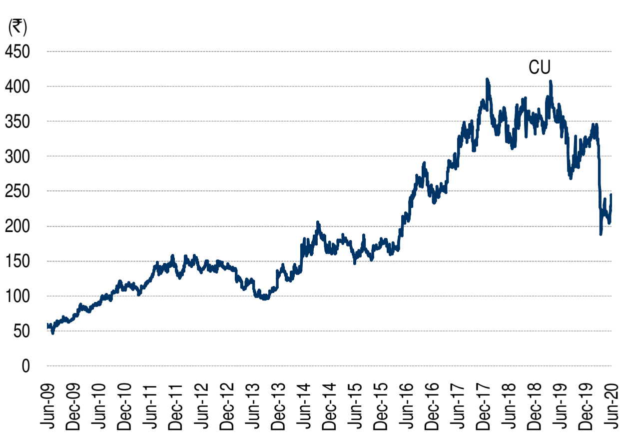
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
P/E (x)	29.9	18.8	16.9	22.2	17.8
EV / EBITDA (x)	16.3	10.4	10.9	11.8	9.6
EV / Sales (x)	2.8	1.7	1.7	1.8	1.5
P/B (x)	4.2	2.7	2.5	2.3	2.1
RoE (%)	14.9	15.1	15.4	10.8	12.2
RoCE (%) - after tax	18.3	19.3	17.4	12.8	14.6
RoIC (%) - after tax	15.9	16.4	18.4	14.4	17.0
DPS (₹ / sh)	2.3	2.8	3.1	2.3	2.9
Dividend yield (%)	0.6	1.1	1.2	0.9	1.2
Dividend payout (%) - incl. DDT	19.4	21.0	21.0	21.0	21.0
Net debt / equity (x)	-0.0	-0.1	-0.2	-0.2	-0.2
Receivables (days)	74	71	57	60	62
Inventory (days)	69	73	72	74	76
Payables (days)	30	28	27	26	24
CFO : PAT %	97.0	74.6	155.4	136.3	76.0

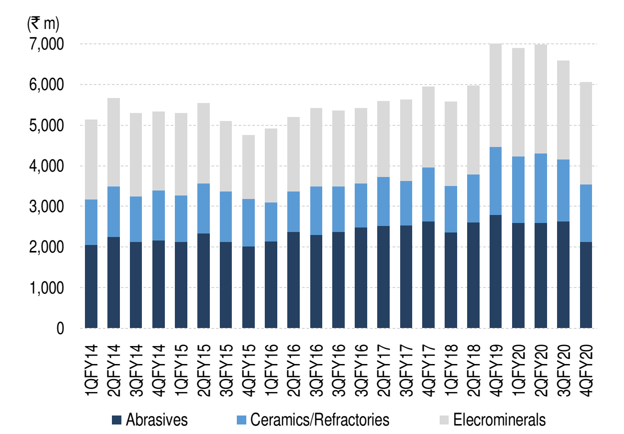
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Sales mix



Source: Company

Result Highlights

Fig 7 – Segment-wise results (consolidated)

(₹ m)	Q4 FY19	Q4 FY20	Y/Y (%)	FY19	FY20	Y/Y (%)
Revenue						
Abrasives	2,797	2,131	*(23.8)*	11,244	9,953	*(11.5)*
Ceramics	1,664	1,401	*(15.8)*	6,044	6,290	*4.1*
Electro-minerals	2,702	2,515	*(6.9)*	10,185	10,258	*0.7*
Others	144	171	*18.8*	639	708	*10.9*
EBIT margins %						
Abrasives	11.5	10.8	-67.5	12.5	11.3	-111.7
Ceramics and Plastics	14.5	25.6	1,102.9	17.9	20.9	304.6
Electro-minerals	13.5	12.8	-72.2	12.6	10.2	-240.5

Source: Company

Fig 8 – Segment-wise results (standalone)

(₹ m)	Q4 FY19	Q4 FY20	Y/Y (%)	FY19	FY20	Y/Y (%)
Revenue						
Abrasives	2,308	1,737	*(24.7)*	9,209	8,147	*-11.5*
Ceramics	1,346	1,079	*(19.8)*	4,985	5,120	*2.7*
Electro-minerals	1,121	1,011	*(9.8)*	4,534	4,109	*-9.4*
Total	**4,776**	**3,828**	*(19.8)*	**18,728**	**17,376**	***-7.2***
EBIT margins (%)						
Abrasives	13.4	12.5	-93.2	14.1	13.3	-79.5
Ceramics and Plastics	14.5	21.9	745.6	16.4	19.5	314.3
Electro-minerals	12.8	6.3	-646.8	9.8	5.3	-452.0

Source: Company

Fig 9 – Cost-structure trend and margins (consolidated)

(₹ m)	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
Sales	5,599	5,195	5,872	6,116	6,495	6,343	6,596	6,929	7,021	6,714	6,843	6,494	5,940
Material cost	1,958	1,682	2,060	2,051	2,257	2,197	2,334	2,571	2,448	2,384	2,440	2,253	1,793
Employee cost	695	757	761	790	801	826	843	791	813	840	917	886	805
Power and fuel	667	776	768	835	896	875	914	1,018	979	955	937	900	925
Other expenses	1,357	1,257	1,224	1,403	1,383	1,371	1,421	1,517	1,589	1,583	1,504	1,491	1,392
% of sales													
Material cost	35.0	32.4	35.1	33.5	34.8	34.6	35.4	37.1	34.9	35.5	35.7	34.7	30.2
Employee cost	12.4	14.6	13.0	12.9	12.3	13.0	12.8	11.4	11.6	12.5	13.4	13.6	13.5
Power and fuel	11.9	14.9	13.1	13.7	13.8	13.8	13.9	14.7	13.9	14.2	13.7	13.9	15.6
Other expenses	24.2	24.2	20.8	22.9	21.3	21.6	21.5	21.9	22.6	23.6	22.0	23.0	23.4
Margins	16.5	13.9	18.0	17.0	17.8	16.9	16.4	14.9	17.0	14.2	15.3	14.9	17.3

Source: Company

Fig 10 – Cost-structure trend and margins (standalone)

(₹ m)	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
Sales	3,822	3,260	3,895	4,115	4,493	4,154	4,426	4,641	4,600	4,307	4,400.5	4,150	3,655
Material cost	1,658	1,373	1,704	1,716	1,851	1,707	1,869	2,063	1,881	1,795	1,804.3	1,696	1,302
Employee cost	374	416	427	457	443	476	475	431	439	495	527.4	527	410
Power and fuel	345	377	365	417	465	445	485	534	465	470	454.2	429	456
Other expenses	865	721	735	884	918	839	867	889	984	937	944.3	876	795
% of sales													
Material cost	43.4	42.1	43.7	41.7	41.2	41.1	42.2	44.5	40.9	41.7	41.0	40.9	35.6
Employee cost	9.8	12.8	11.0	11.1	9.9	11.5	10.7	9.3	9.5	11.5	12.0	12.7	11.2
Power and fuel	9.0	11.6	9.4	10.1	10.3	10.7	11.0	11.5	10.1	10.9	10.3	10.3	12.5
Other expenses	22.6	22.1	18.9	21.5	20.4	20.2	19.6	19.2	21.4	21.8	21.5	21.1	21.7
Margins	15.2	11.4	17.0	15.6	18.2	16.6	16.5	15.6	18.1	14.2	15.2	15.0	18.9

Source: Company

Concall highlights

Electro-minerals

- Management indicated of drop in realisations in FY20.
- The slowdown in standalone revenue stemmed from lower sales to abrasives and refractory companies due to the lockdown in the domestic market.
- VAW sales grew 61% y/y during the quarter.
- The electro-minerals business is categorised primarily into commoditised products (a mass market; fused AL, siC) and specialty products (DPF fine powder, zirconia). The product-mix is key. The company is well positioned in the mass market in Russia and India. This can be cost-effective. The increase in specialty electro-minerals (which helps expand margins), more applications in conventional areas and emerging (battery and EV) segments will counter-balance margins.

Ceramics

- Reasonable improvement in metallised cylinders. Would see traction from the power GTD market.
- Industrial and super-refractories enjoyed better margins. A better product-mix is key to support margins ahead.
- The company invested ₹150m in metallized cylinders. Management expects a 0.5m-piece increase in capacity this year. Hence, total capacity would be 2.2 tonnes by H2 FY21. Exports are doing well, while one large customer in the domestic market has stopped purchases.
- Product launches will be in wear materials, expanding from ceramics into other materials as well, composite and electronic ceramics.
- Cost efficiency, technology and product development would be the key focus areas ahead.

Abrasives

- In the domestic market, abrasives continued to be hit by the slowdown in key industries, including auto, auto-ancillaries and construction.
- The drop in abrasives was due to the dip in bonded and precision abrasives (better margins, better realisations), which are being supplied to the construction and auto & auto-component sectors.
- The product mix has shifted from high precision (used in auto and its ancillaries) to coated abrasives (used in construction, wood-working and infrastructure), which command a mass market. The present product-mix is 55% bonded, 45% coated.
- The abrasives margin in Q4 FY20 was impacted by the lockdown, leading to lower volumes. The B2B precision abrasives (bonded) was impacted by the slowdown in auto, construction and other key industries. Abrasives margins are likely to improve as demand picks up.

Others

- While capex for next year has been rationalised in line with the present situation, the focus will be on expanding the ceramics and refractories business in Russia. Also, to reduce the fixed costs, investments will be made in digitisation/automation.
- In Russia, the company will continue to invest in bonded abrasives and silicon carbide refractories.
- EMD: The focus this year would be leveraging volumes and sweating assets, thereby improving profitability.
- The company would like to benefit from any client seeking to diversify sourcing from China.

Valuation

Abrasives will continue to be constrained until manufacturing picks up. Ceramics would add to healthy growth because of good demand in Australia and in metallised cylinders.

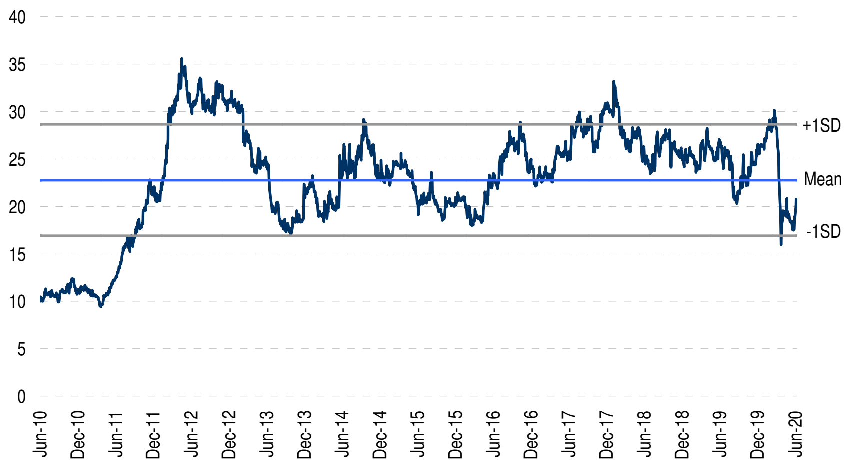
With its focus on operating efficiency, cost-control, launches of products in ceramics and quitting the loss-suffering Foskor Zirconia this year, management is confident of steady margins ahead. We recommend a Buy on the stock, with a revised TP of ₹303 (22x FY22e).

Fig 11 – Change in estimates

	Original estimates		Revised estimates		Change (%)	
(₹ m)	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e
Revenue	23,562	25,395	23,801	27,032	1.0	6.4
EBITDA	2,916	3,537	3,546	4,308	21.6	21.8
EPS (₹)	8.9	11.0	11.4	13.6	24.1	25.1

Source: Anand Rathi Research

Fig 12 – One-year-forward PER



Source: Company

Key risks

- **Highly responsive to growth (or the lack of it) in user industries:** Slowdown in user industries could lead to Carborundum Universal's growth contracting.
- **Delay in sale of Foskor Zirconia:** If management cannot find a suitable buyer, margins would keep shrinking.

Appendix

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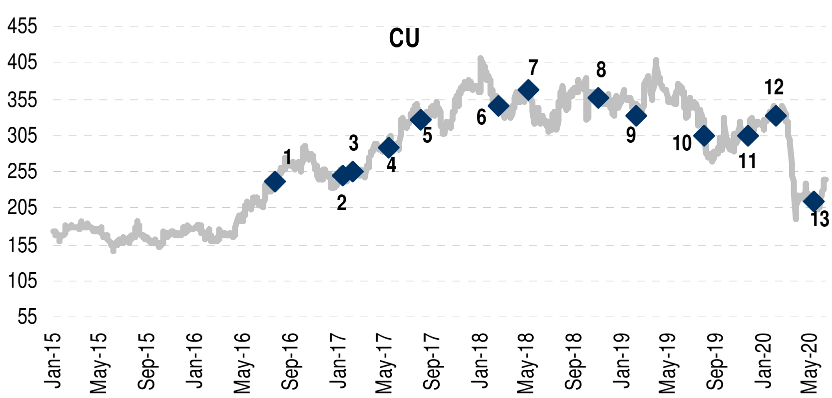
Rating and Target Price History (as of 9 June 2020)



	Date	Rating	TP (₹)	Share Price (₹)
1	22-Jul-16	Buy	396	247
2	16-Jan-16	Buy	352	256
3	08-Feb-16	Buy	373	260
4	11-May-16	Buy	386	296
5	02-Aug-17	Hold	359	336
6	19-Feb-18	Hold	419	351
7	08-May-18	Hold	427	351
8	02-Nov-18	Hold	400	360
9	06-Feb-19	Hold	422	360
10	02-Aug-19	Hold	320	309
11	20-Nov-19	Hold	351	306
12	31-Jan-20	Hold	367	334
13	11-May-20	Hold	245	213

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Ratings Guide (12 months)	Buy	Hold	Sell
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